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PRETORIA 00000325 001.2 OF 004

¶1. (U) Summary. This is Volume 8, issue 7 of U.S. Embassy Pretoria's South Africa Economic News Weekly Newsletter.

Topics of this week's newsletter are:
- Industrial Policy to Receive Infusion of Funds
- SA to Fast-Track Investment Process
- Mbeki Outlines ICT Priorities
- SARB Emphasizes Growth over Inflation
- South Africa's Rand Depreciates
- Growth Target Revised
- Analysts Debate Need for Tax-relief
- Retail Sales at Six-Year Low
- Credit Rating Remains Stable
- PetroSA: Crude, But Effective
- Lanseria Airport Expands
- Cell C Recovery Campaign Pays Off
End Summary.

Industrial Policy to Receive Infusion of Funds

¶2. (U) President Mbeki said in his February 8 State of the Nation address that the government's industrial policy will be reinforced with an injection of state funds amounting to R7.3 billion ($1 billion) over the next three years. R5 billion ($714 million) will be earmarked for tax incentives and the remainder will be dedicated to other forms of initiatives. Further details on the funding package are to be released as part of Finance Minister Trevor Manuel's budget speech for 2008-2009 on February 20. The industrial policy identifies several high priority sectors for development, including automotive, chemical and pharmaceuticals, capital equipment and mining beneficiation, and forestry and pulp. Incentives will also be provided for other sectors including tourism, business process outsourcing and the development of arts and craft hubs, according to Department of Trade and Industry's Acting Deputy Director-General Sipho Zikode. (Business Day, February 11, 2008).

SA to Fast-Track Investment Process

¶3. (U) President Mbeki also said that South Africa would fast track investment application processes and speed up infrastructure provision to support continued economic growth. He unveiled plans to set up a call center to help prospective investors track applications, such as environmental-impact assessments. This call center would also aim to speed up the application process for land acquisition and infrastructure. Mbeki admitted that the "tardiness" with which government departments dealt with these applications could "make or break investor decisions". He continued that the government was "urgently" setting up the call center, which would also help government departments track progress. (Engineering News, February 8, 2008)

Mbeki Outlines ICT Priorities

¶4. (U) President Mbeki also pointed to the information and communication technology (ICT) infrastructure as a "critical priority, both as a facilitator and as a sector". He stated that South Africa would complete the licensing process for Infraco, a state-owned broadband infrastructure company, in 2008. Mbeki added that the government has allocated money for signal broadcaster Sentech to become a wireless Internet wholesaler, as well as to finance its digitization. Mbeki expects to provide digital
Qdigitization. Mbeki expects to provide digital broadcasting to 50% of the population by the end of 2008. (Engineering News, February 8, 2008)

SARB Emphasizes Growth over Inflation

¶5. (U) The South African Reserve Bank's (SARB) Monetary Policy Committee (MPC) left the policy interest rate unchanged for the first time in nine months, at 11.0%. In doing so, the MPC gave more weight to domestic and global economic uncertainties and the moderation of domestic consumption spending than to South Africa's deteriorating inflation outlook. CPIX-inflation (consumer price inflation excluding mortgage interest rates) has exceeded the upper end of the inflation target range of 3-6% for the ninth consecutive month, reaching an almost 5-year high of 8.6% in December 2007. Inflation was mostly driven by food and energy prices. The MPC expected inflation to remain above the target range until the end of 2008, with the main risks to inflation arising from food, fuel and electricity prices as well as the weakening rand exchange rate. Most analysts, businesses and consumers welcomed the MPC's decision.

South Africa's Rand Depreciates

¶6. (U) South Africa's Rand depreciated by 13.7% against the dollar between January 1 and February 13, 2008. The depreciation was spurred by heavy sales of local shares and bonds by foreigners. The main reasons for the heavy selling of local assets were the electricity supply problem, its impact on economic growth, and fears about South Africa's ballooning current account deficit.

Growth Target Revised

¶7. (U) Treasury Director-General Lesetja Kganyago said South Africa was unlikely to reach its target of 6% economic growth by 2010 because of slower global expansion and domestic energy problems. Kganyaho added that the 4.5% growth rate estimated for 2008 in the medium-term budget policy statement would also be revised. However, she played down concerns that the economy could fall into recession, predicting that the revision of growth targets would not be large. She noted that the economy remained resilient. The economy has grown at an average of about 5% over the past four years. "What we have actually seen is that current global turmoil will push that back, but talks of a recession are misplaced," said Kganyago. (Business Report, February 11, 2008)

Analysts Debate Need for Tax-relief

¶8. (U) Analysts debated the need for tax relief in Finance Minister Trevor Manuel's next budget. Taxpayers have received R89.2 billion ($11.7 billion) in tax relief since Manuel's first 1997 budget and some analysts called for further relief. Manuel signaled a policy in his October 2007 budget policy statement to accumulate budget surpluses when the economy is growing strongly, to moderate excessive spending, and to run deficits when growth in the economy slows and needs a boost. Manuel had budgeted for a R16.2 billion ($2.1 billion) surplus in 2008 on the expectation that the economy would grow 4.5%. However, power cuts and a global slowdown have reduced growth prospects. Brait Economist Colen Garrow said this change justified a shift
QEconomist Colen Garrow said this change justified a shift
towards deficit spending and called for more tax breaks. Sanlam Group Chief Economist Jac Laubscher believed that the government needed to opt for a stimulatory budget and should raise capital spending instead. Other analysts would like to see a balanced budget. Absa Economist Ridle Markus urged caution in spending as "this is not the time to overspend". However, he said that priority should be given to Eskom's expansion plans and that some of the funding should come from the government. (Business Report, February 11, 2008)

Retail Sales at Six-Year Low

¶9. (U) Statistics South Africa (StatsSA) reported that retail sales decreased by 0.5% y/y in December, the lowest level in six years. Retail sales slowed from a 9.6% growth rate in 2006 to 5.1% in 2007, the lowest annual growth rate in three years. Analysts said the fall in the main gauge of consumer spending provides further confirmation of slowing consumer spending on the back of rising inflationary pressures, high debt levels, and high interest rates. It confirms concerns raised by some analysts that South Africa is heading into a consumer recession on a real basis. The South African Reserve Bank (SARB) raised interest rates by 400 basis-points between June 2006 and December 2007 in an effort to bring inflation under control. Consumer spending has been the main driver of economic growth in the past few years and its decline could depress gross domestic product expansion in 2008. The slower growth, which may be further dampened by a crippling energy crisis, could close the door on more rate hikes, and some analysts are starting to look ahead to possible cuts later this year or in early 2009, despite a still bleak inflation outlook. (Fin 24, February 13, 2008)

Credit Rating Remains Stable

¶10. (U) The global and domestic challenges facing South Africa do not threaten the stable outlook on its mid-investment grade rating, global rating agency Standard & Poor's said on February 14. "As long as the slowdown is moderate, it won't undermine the outlook we have," said S&P Managing Director for South Africa and sub-Saharan Africa Konrad Reuss. Reuss predicted that gross domestic product growth would slow to 4% in 2008, in contrast to average growth of 5% over the last four years. Reuss said S&P did not foresee a recession for South Africa, since the extent and duration of power cuts that hit business, industry and homes in January were unlikely to be repeated. He also played down the substantial outflows from local equity markets last month, which will make it harder to finance South Africa's large current account deficit. "At this point, from what we have seen and heard, investors have not turned negative on South Africa. But it highlights the fact that all the players and decision makers will have to tread carefully," Reuss said. S&P officially opened its South Africa office in Johannesburg on February 13. (Business Day, February 15.)

PetroSA: Crude, But Effective

¶11. (U) National oil company PetroSA has won "tacit" approval to build an oil refinery at the Coega Industrial Development Zone near Port Elizabeth. The "Mthombo"-dubbed project for a 200,000 barrel per day refinery was mooted last year. A Coega spokesman said the project should break ground in 2010 and be completed in 2014/2015. Two competing projects appear to have fallen by the wayside: Bidevco (a BEE company) partnered with Brazilian oil company IOR and South African Drako Oil - with ambitious plans for three refineries in South Africa. PetroSA's Qplans for three refineries in South Africa. PetroSA's spokesman said the Mthombo plant would be in line with the parastatal meeting its obligation to guarantee the country's fuel security. The Mthombo plant would also be in line with a draft energy security master plan for the liquid fuels industry. South Africa refines 700,000 barrels of oil per day, but imported as much as 1.2 billion liters (7.6 million barrels) of refined product last year. There has been a lack of investment, largely due to the unexpected surge in demand for liquid fuels and the poor returns offered by such large capital-intensive investments. PetroSA says the Mthombo plant is sized to satisfy South African demand, but could be expanded to

allow for exports and growth opportunities. (Financial Mail, February 15, 2008)

Lanseria Airport Expands

¶12. (U) Lanseria International Airport Manager Gavin Sayce reported that increased domestic flight offerings have prompted a number of expansion projects. Sayce said the expansion was driven by Kulula Airline's new daily flights from Lanseria to popular domestic destinations such as Cape Town, Durban, Port Elizabeth, and East London. The Lanseria airport decided in October 2007 to increase its apron capacity by about 215,280 square feet. Sayce added that a new terminal building could be built to serve domestic flights, with the existing terminal building serving international flights. The airport can currently accommodate 500,000 passengers a year. According to Sayce, Lanseria is aspiring to develop into an airport that will serve the sub-Saharan African region. "With the increased flights coming into OR Tambo International, a lot of flights could be diverted to Lanseria." The imminent introduction of Boeing A380s at OR Tambo means that the

airport will have to increase its capacity. During this phase, "Lanseria will be needed to serve passenger overflow," said Sayce. Lanseria can accommodate the Boeing 757-300 and the Airbus A319. (Engineering News, February 8, 2008)

Cell C Recovery Campaign Pays Off

¶13. (U) Mobile operator Cell C expected full-year core profit to rise by over 30% as a turn-around plan pays off. Newly appointed CFO Fabrizio Mambrini said the struggling mobile firm's expected revenue growth would be "quite outstanding" after it launched a drive to increase subscribers. "The company has made significant improvements in 2007 already." he said. Unlisted Cell C, which releases its full-year results in March, has struggled to carve out market share in South Africa and has been weighed down by enormous debts. Mambrini said Cell C's recovery campaign, which includes a range of promotions and a plan to focus on the lower end of the market, had borne fruit. Cell C had 3.3 million South African subscribers at the end of June 2007, compared with rival Vodacom's 24 million and MTN's 14 million. Mambrini said he saw room for growth despite talk that the South African market, with up to 80% mobile phone penetration, is saturated. (Engineering News, February 12, 2008)

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